

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**Recap of Procurement Problems
Identified in Audits of Electric
Cooperatives**



Dallas Field Office
Office of Audits

DD-11-06

September 2006



**Homeland
Security**

September 8, 2006

MEMORANDUM FOR: John R. (Jack) D'Araujo, Jr.
Director, Recovery Division
Federal Emergency Management Directorate

FROM: 
for Tonda L. Hadley
Field Office Director

SUBJECT: *Recap of Procurement Problems Identified in Audits of
Electric Cooperatives*
Audit Report Number DD-11-06

The purpose of this report is to bring to your attention recurring procurement problems we have identified in audits of electric cooperatives and to request your assistance in preventing similar problems from occurring in future disasters. We have included selected information from nine audit reports of the Federal Emergency Management Directorate (FEMA) Public Assistance (PA) sub grants awarded to electric cooperatives in FEMA Regions V, VI and VIII (see Exhibit). We performed the audits under the authority of the Inspector General Act of 1978, as amended, and according to generally accepted government auditing standards.

RECAP OF PROCUREMENT PROBLEMS IDENTIFIED

From September 2002 to January 2006, we issued nine audit reports containing findings that electric cooperatives did not follow federal procurement standards in awarding contracts for utility repairs and debris removal work.¹ As a result, full and open competition did not occur and FEMA had no assurance that contract costs were reasonable. The nine audits covered \$59.2 million in electric cooperative subgrantee claims, of which \$39.3 million were for costs incurred under non-competitive contracts.

FEMA grants a substantial amount of federal funding annually to electric cooperatives for natural disasters. For example, FEMA Regions V, VI, VII, and VIII provided \$391 million in federal grants to electric cooperatives from 2000 through 2004.² Based on our experience, we estimate that more than half of that funding reimburses electric cooperatives for costs incurred under contracts that do not comply with federal procurement standards.

¹ Includes work of legacy FEMA Office of Inspector General.

² The federal share of the \$391 million ranged from 75 to 100 percent.

Federal procurement standards at 44 CFR 13.36:

- Require the performance of procurement transactions in a manner providing full and open competition except under certain circumstances. (13.36(c)(1)).
- Allow procurement by noncompetitive proposals only when the award of a contract is infeasible under small purchase procedures [\$100,000 or less], sealed bids, or competitive proposals and certain circumstances apply. One acceptable circumstance is when the public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation. (13.36(d)(4)(i)).
- Require that sub-grantees maintain records sufficient to detail the significant history of the procurement, including the rationale for the method of procurement, the basis for contractor selection, and basis for the contract price. (13.36(b)(9)).
- Require subgrantees to maintain a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. (13.36(b)(2)).
- Prohibit the use of time-and-material-type contracts unless a determination is made that no other contract is suitable and provided that the contract include a ceiling price that the contractor exceeds at its own risk. (13.36(b)(10)).
- Require a cost analysis when adequate price competition is lacking. (13.36(f)(1)).
- Require profit to be negotiated as a separate element of the price for each contract in which there is no price competition and in all cases where cost analysis is performed. (13.36(f)(2)).

Under 44 CFR 13.43(a)(2), *Remedies for noncompliance*, failure to comply with applicable statutes or regulations can result in the disallowance of all or part of the costs of the activity or action not in compliance. However, we did not begin questioning contract costs solely on the basis of improper contracting until 2005. Further, we did not question contract costs incurred during periods of exigency because the procurement standards allow applicants to relax procurement standards when exigent circumstances exist. We considered the lack of power to be an exigent circumstance and, therefore, did not question contract costs (on reports issued after 2005) for work performed before the electrical cooperatives could fully restore power to all customers, generally a month or two after the disaster occurs. We contend that this approach to questioning costs is conservative and reasonable, especially considering that FEMA written guidelines state that this period of relaxed procurement standards generally applies to the first 70 hours immediately after a disaster.

As shown in the table below, electric cooperatives used non-competitive, time-and-material (T&M) contracts without cost ceilings, did not maintain sufficient records for procurement history, and did not perform cost analyses.

Subgrantee	Report # /Date	Violations of Procurement Standards Under 44 CFR Subsection:					
		<u>13.36(b)(9)</u>	<u>13.36(b)(10)</u>	<u>13.36(c)(1)</u>	<u>13.36(f)(1)</u>	<u>13.36(f)(2)</u>	<u>13.36(f)(4)</u>
		Maintain Sufficient Records	T&M Contract Restrictions	Full and Open Competition	Cost Analysis Requirement	Profit Negotiated Separately	Cost-Plus- Percentage- of-Cost Restrictions
Claiborne Electric Cooperative, Inc.	C-10-02 9/16/02	X	X	X			
Lake Country Electric Cooperative	DD-04-03 4/28/03	X	X	X			
Minnkota Power Cooperative, Inc.	DD-01-04 10/29/03	X	X	X	X	X	X
Southwest Arkansas Electric Cooperative, Inc.	C-01-03 12/16/02	X	X	X	X		
Cookson Hills Electric Cooperative, Inc.	DD-13-04 8/9/04		X	X	X	X	X
Kiamichi Electric Cooperative, Inc.	DD-08-05 7/11/05	X	X	X	X	X	
Western Farmers Electric Cooperative (DR-1355)	DD-09-05 9/1/05	X	X	X	X	X	
Western Farmers Electric Cooperative (DR-1401)	DD-06-06 1/17/06	X	X	X	X	X	
Central Rural Electric Cooperative, Inc.	DD-06-05 5/17/05	X	X	X	X	X	

Generally, these violations occurred because the electric cooperatives either disregarded these procurement standards or were not aware of them. Further, neither the states, as grantees, nor FEMA, as the responsible federal funding source, enforced the standards when the electric cooperatives submitted their claims for reimbursement of disaster costs. Accordingly, we have consistently recommended that FEMA Regional Directors, in conjunction with the states, develop and implement procedures for future disasters to ensure that subgrantees are knowledgeable of and follow federal procurement standards. However, we have seen no improvement in electrical cooperatives' compliance with procurement standards; and FEMA has recovered none of the \$10.2 million we questioned in contract costs for the nine audits.

Electric cooperative officials and state grantees contended that federal procurement standards are too restrictive and impractical for them to use for disaster recovery work. However, these federal procurement standards are in place to ensure that grantees and subgrantees provide full and open competition and obtain fair and reasonable prices for work funded under FEMA grants. Therefore, FEMA Regional Directors and state grantees must work together to improve compliance.

We recommend that the Director, FEMA Recovery Division, require all FEMA Regional Directors to:

1. Provide additional training on federal procurement standards to grantees.
2. Require grantees to develop and implement procedures for future disasters to ensure that electric cooperatives are knowledgeable of and follow federal procurement standards.

3. Require grantees to enforce compliance with federal procurement standards for FEMA Public Assistance grants to electric cooperatives by disallowing costs incurred under contracts that do not comply with the standards.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We provided a discussion draft report to FEMA officials on July 29, 2006; and, on August 17, 2006, we discussed the report with the Chief, Public Assistance, Recovery Division, who agreed with our findings and recommendations.

Please advise this office by November 8, 2006, of the actions taken or planned to implement our recommendations. Please include target completion dates for any planned actions. Should you have any questions concerning this report, please call me, or your staff may contact Paige Hamrick at (940) 891-8900.

**AUDIT REPORTS ISSUED FROM 2002 TO 2006 ON ELECTRIC COOPERATIVES IN
FEMA REGIONS V, VI, AND VIII**

Audit Report Date	Report No.	Disaster Year	Electric Cooperative	State	Total Claim	Questioned Improper Contracting Costs	Percent of Total Claim	Non- Competitive Contract Amount	Percent Of Total Claim Not Competed
09/16/2002	C-10-02	1998	Claiborne Electric Cooperative, Inc.	LA	\$ 1,690,000	\$ 0	0.0%	\$ 1,159,274	69%
04/28/2003	DD-04-03	1999	Lake Country Electric Cooperative	MN	2,100,000	0	0.0%	1,593,498	76%
10/29/2003	DD-01-04	1999	Minnkota Power Cooperative, Inc.	ND	6,760,000	0	0.0%	4,015,277	59%
12/16/2002	C-01-03	2000	Southwest Arkansas Electric Cooperative, Inc.	AR	15,170,000	0	0.0%	11,433,363	75%
08/09/2004	DD-13-04	2000	Cookson Hills Electric Cooperative, Inc.	OK	5,200,000	0	0.0%	907,274	17%
07/11/2005	DD-08-05	2000	Kiamichi Electric ✓ Cooperative, Inc.	OK	9,650,000	4,883,714	50.6%	8,381,786	87%
09/01/2005	DD-09-05	2000	Western Farmers Electric Cooperative	OK	2,050,000	0	0.0%	592,643	29%
01/17/2006	DD-06-06	2002	Western Farmers Electric Cooperative	✓OK	11,100,000	\$3,480,799	31.4%	7,947,354	72%
05/17/2005	DD-06-05	2002	Central Rural Electric Cooperative, Inc.	✓OK	<u>5,450,000</u>	<u>1,802,562</u>	<u>33.1%</u>	<u>3,239,787</u>	<u>59%</u>
					<u>\$59,170,000</u>	<u>\$10,167,075</u>	<u>17.2%</u>	<u>\$39,270,256</u>	<u>66%</u>

Rural Electric Cooperatives: Procurement/Contracting Guidance



Objectives

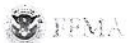
- To ensure Rural Electric Cooperatives are knowledgeable of and follow federal procurement standards
- To identify and offer remedies for recurring contracting problems identified by OIG Audits



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References

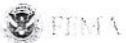
- 44 CFR Part 13.36
- FEMA 321 Policy Digest
- FEMA 322 Public Assistance Guide



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Federal Contracting

- RECs should comply with
 - Their own procurement procedures
 - State and Local laws and regulations
 - Applicable Federal laws and standards

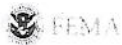


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Federal Contracting Process

Essential Elements

- ✓ Competition
- ✓ Scope of work
- ✓ Qualified proposers/bidders
- ✓ Cost analysis/price reasonableness
- ✓ Contract must comply with all Federal, State and local requirements
- ✓ Documentation



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Acceptable Contracts

- Lump Sum
- Unit Price
- Cost Plus Fixed Fee
- Time and Materials/Equipment in limited situations



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Unacceptable Contracts

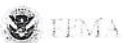
- Cost Plus Percentage of Cost
- Contingency



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Office of Inspector General Audits

- Federal Grants to RECs from 2000 to 2004: \$391M
- 9 Audits conducted between 2002-2006
- \$59.2 million claimed
- \$39.2 million for non-competitive contracts



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OIG Audits: Typical Areas of Noncompliance (1)

- Full and open competition - 13.36 (c)(1)
- Maintain sufficient documentation - 13.36(b)(9)
- Cost analysis requirement - 13.36(f)(1)
- Time and materials contract restrictions - 13.36(b)(10)



OIG Audits: Typical Areas of Noncompliance (2)

- Cost plus percentage of cost restrictions - 13.36(f)(4)
- Profit negotiated separately - 13.36(f)(2)
- Lack of a contract administration system - 13.36(b)(2)



Full and Open Competition

- Intended for all procurements
- Avoid restricting competition
 - Placing unreasonable requirements for firms to qualify
 - Requiring unnecessary experience
 - Requiring brand names, but not "or equal"
 - Making noncompetitive awards
 - Other arbitrary actions in the procurement process



Maintain Sufficient Documentation

- Facilitates federal grants process
- Must detail significant history of a procurement
 - Rationale for
 - Method of procurement
 - Selection of contract type
 - Contractor for contractor selection or rejection
 - Basis for contract price



Cost Analysis Requirement

■ Cost or price analysis

- Is required for every procurement action
- Independent estimates must be prepared
- Goal: defensible and reasonable cost



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Time and Materials Contract Restrictions

Use ONLY

- If no other contract type is suitable
- If the contract includes a not-to-exceed ceiling price, contractor exceeds at its own risk
- Can be used for emerg. restoration of power
 - Careful Applicant monitoring and documentation of work and costs
 - Contact State to ensure proper guidelines are followed



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Cost Plus Percentage of Cost Restrictions

- Strict prohibition against
- Contractor
 - Adds overhead/profit percentage to each dollar invoiced
 - Has no incentive to be efficient or cost effective
 - Bears virtually no risk



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Profit Negotiated Separately

- Required when cost analysis is performed
- Fair and reasonable profit considers
 - Complexity of the work
 - Amount of contractor risk and investment
 - Amount of subcontracting
 - Quality of past performance
 - Local industry standard rates



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Lack of a Contract Administration System

- OIG saw no improvement in REC compliance
- Contract Administration System should
 - Be in place for future disasters
 - Develop and implement written, compliant procedures
 - Ensure adequate competition
 - Structure and award pre-placed contracts
 - Protect future federal grants



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Suggestions

- Contracts can be developed, and formats, solicitation process, etc., can be shared among the REC network
- Contracts can be prepared during "normal," non-contingency periods
- Competitively obtained, pre-placed, pre-priced contracts could help ensure compliance with federal requirements as well as successful response and recovery



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REC Contracting: Summary

- RECs are NOT exempt from Federal contracting requirements
- Need effective contract administration and documentation procedures
- Mutual aid support and time and materials contract format are for emergency response to restore power



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REC Contracting: Summary

- Use acceptable contract types for permanent recovery work
- Effective pre-disaster contract planning will help
- Failure to follow federal contracting requirements could impact eligibility for federal grants assistance



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FEMA